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## Income Tax Consequences of Cuban Expropriations to Cuban Resident Aliens

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# INCOME TAX CONSEQUENCES OF CUBAN EXPROPRIATIONS TO CUBAN RESIDENT ALIENS

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## I. INTRODUCTION

The Castro-Communist dictatorship in Cuba has created numerous problems with various governmental agencies, not the least of which is the State Department. The revolution has also plagued the Internal Revenue Service, and the effect on the tax collectors is of interest, particularly, in areas where large numbers of Cuban refugees have congregated after fleeing Cuba.

A brief review of the facts leading up to the revolution and some of the earlier pronouncements of the Castro government is desirable in analyzing the effects of the confiscation of private properties in Cuba on United States taxes.

On March 10, 1952, Fulgencio Batista became dictator of Cuba, following a military Coup d'état.<sup>1</sup> The following year on July 26, 1953,

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1. INT'L COMMISSION OF JURISTS, CUBA AND THE RULE OF LAW 4 (1962).

Fidel Castro led an unsuccessful attack on the Moncada barracks in Santiago de Cuba and Castro was arrested, tried and sentenced to prison.<sup>2</sup> On November 1, 1954, Batista was "elected" President without opposition and under a general amnesty a number of political prisoners including Castro were released from prison. On December 2, 1956,<sup>3</sup> Castro landed in Cuba from Mexico with 82 followers and established a revolutionary force in the Sierra Maestra mountain in the Oriente Province of southern Cuba.<sup>4</sup>

Castro's revolutionary movement generated popular support under the banners of freedom and democracy. Its main objective was to overthrow the dictatorship of Batista and to restore Cuba to a constitutional government based on the framework of the Cuban Constitution of 1940.<sup>5</sup> The revolutionary force fought bravely for over two years and successfully overthrew the Batista Government on January 1, 1959.<sup>6</sup>

In August of 1959, it was becoming apparent that little attempt was being made to restore Cuba to a constitutional government. Critics of the Castro Government were frequently arrested and tried by revolutionary councils on charges of treason and counter-revolutionary activities.<sup>7</sup>

During 1959 and 1960 the Cuban Government embarked upon a property nationalization program designed to expropriate the properties of all United States citizens and corporations. The Cuban expropriation program began with the Land Reform Act of May 17, 1959,<sup>8</sup> which established the National Land Reform Institute, and by the end of 1960, an estimated one billion dollars of United States investments had been seized by the communist government of Fidel Castro.<sup>9</sup> On January 3, 1961, the United States broke off diplomatic relations with the Cuban Government principally as a result of the confiscatory program of the Cuban Government.<sup>10</sup>

As a result of these political developments, numbers of Cuban nationals began to leave Cuba for the United States during 1960. Most of them were not able to sell their properties before departing and their

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2. *Id.* at 4.

3. *Id.* at 4.

4. *Id.* at 4.

5. *Id.* at 78.

6. ANNUAL REPORT OF IMMIGRATION AND NATURALIZATION SERVICE 53 (1964) reports on the number of temporary visitors from Cuba were as follows:

1959-56, 655; 1960-43, 123; 1961-30, 633; 1962-10, 681; 1963-3, 276; 1964-3, 803.

Many such Cuban nationals remained in the United States. See Rev. Rul. 149, 1964-1 CUM. BULL. 233.

7. INT'L COMMISSION OF JURISTS, CUBA AND THE RULE OF LAW 5 (1962).

8. Official Gazette (Special Ed. June 3, 1959).

9. U.S. Dept. of Commerce, U.S. Business Investments in Foreign Countries—a Supplement to the Survey of Current Business 89 (1960).

10. INT'L COMMISSION OF JURISTS, CUBA AND THE RULE OF LAW 6 (1962).

properties were subsequently confiscated by the Cuban Government.<sup>11</sup> In many cases, the authority for expropriation and the date of loss are extremely obscure as the Cuban Government frequently appointed "outside" directors or managers to oversee the operation of an individual's business before actually taking the business from the individual. Many such Cuban nationals became "taxpayers" of the United States shortly before their properties were confiscated by the Cuban Government. In such cases, the question has arisen whether the new "taxpayers" are entitled to deductions for the loss of their Cuban properties. This situation has been created by a unique judicial rule of tax law which gives a resident alien an income tax basis for foreign property acquired *before* the alien entered the United States.

The object of this article is to analyze the income tax treatment of Cuban losses suffered by Cuban nationals who became resident aliens during this period. The first part of this article will discuss the statutory, judicial and administrative income tax principles governing foreign expropriation losses. The latter part of this article will discuss the application of the preceding income tax principles to the Cuban resident alien cases.<sup>12</sup>

## II. TAX EFFECTS OF CUBAN EXPROPRIATIONS

### A. *Statutory and Judicial Interpretation*

The Cuban nationalization laws generally made provisions for compensating United States citizens and corporations for the taking of their Cuban-owned properties.<sup>13</sup> However, it soon became apparent that the Cuban Government did not intend to honor these obligations. The Castro Government eventually adopted a policy of taking property at gunpoint without even the publication of an official notice or the issuance of a receipt. In view of the "no-pay-for-taking" attitude adopted by the Cuban Government, it was argued that the Cuban seizures should be treated as deductible losses under the general loss provisions of Section

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11. Law 890 of October 13, 1960, Official Gazette (Special Ed. Oct. 13, 1960); Urban Reform Law of Oct. 14, 1960, Official Gazette (Special Ed. Oct. 14, 1960); Law 989 of December 5, 1961, Official Gazette (Dec. 6, 1961).

12. For an excellent discussion of the income tax law prior to the Revenue Act of 1964, See: Patty, *Tax Aspects of Cuban Expropriation*, 16 TAX L. REV. 415 (1960); Kramer, *The Tax Effects of Cuban Expropriations*, 39 TAXES 309 (1961). For an interesting discussion of the changes effected by the Revenue Act of 1964, See: Clauss, *Foreign Expropriation Losses*, 43 TAXES 201 (1965).

13. Generally the Cuban nationalization laws provided for the issuance of Cuban Government bonds. Agrarian Reform Law of May 17, 1959, Official Gazette (Special Ed. June 3, 1959); Law 851 of July 6, 1960, Official Gazette (July 7, 1960); Urban Reform Law of October 14, 1960 (Special Ed. Oct. 14, 1960). However, the nationalization laws did not provide an effective amortization plan or sinking fund for retirement of the bonds and it now appears that the bonds were not actually issued to any United States citizens or corporations. Our State Department at an early date referred to such Cuban laws as "discriminatory, confiscatory and arbitrary." State Department Press Release No. 575, Sept. 30, 1960.

165(a) of the Internal Revenue Code of 1954.<sup>14</sup> This Code section provides in part, that a taxpayer shall be allowed as a deduction "any loss sustained during the taxable year and not compensated for by insurance or otherwise."<sup>15</sup>

The Treasury Regulations interpreting Section 165(a) provide that the loss "must be evidenced by closed and completed transactions, (and) fixed by identifiable events."<sup>16</sup> The loss will be disallowed where there exists a claim for reimbursement for which "there is a reasonable prospect of recovery."<sup>17</sup> Under such circumstances, the loss is deferred until it can be ascertained with reasonable certainty if a recovery will be effected.

Considerable confusion and uncertainty existed during 1959 and 1960 as to whether the Cuban Government would honor its promise of indemnification. During this period, the Internal Revenue Service failed to issue a pronouncement on whether the Cuban seizures gave rise to deductible losses. However, by the end of 1961, it was fairly certain that there was little, if any, "reasonable prospect of recovery" for properties taken by the Cuban Government.<sup>18</sup> The facts surrounding the Cuban seizures evidenced "closed and completed transactions" and were "fixed by identifiable events," thereby justifying deduction under Section 165(a).

The argument for treating the Cuban seizures as deductible losses was supported by a series of foreign confiscation decisions beginning with *United States v. White Dental Manufacturing Co.*, which was decided under the Revenue Act of 1918.<sup>19</sup>

In *White Dental*, the German Government, during World War I, seized the taxpayer's wholly-owned German subsidiary and in March of 1918, appointed a German sequestrator to manage the subsidiary. In 1920, the seized properties were returned to the taxpayer, but due to mismanagement, the assets of the corporation had been dissipated and were sold in 1922 for \$6,000. In 1924, the taxpayer filed a claim for

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14. Patty, *Tax Aspects of Cuban Expropriations*, 16 TAX L. REV. 415, 422 (1961); Kramer, *The Tax Effects of Cuban Expropriations*, 39 TAXES 309, 311 (1961).

15. INT. REV. CODE OF 1954, § 165(a).

16. Treas. Reg. § 1.165-1(b) (1961). It is incumbent upon the taxpayer to claim the loss in the earliest year for which it may be possibly allowed to avoid a statute of limitation problem under § 6511 of the INTERNAL REVENUE CODE OF 1954. In certain cases it will be advisable to renew the claim in subsequent years. *Young v. Commissioner*, 123 F.2d 597 (2d Cir. 1941); *Wyman v. United States*, 166 F. Supp. 766 (Ct. Cl. 1958).

17. Treas. Reg. § 1.165-1(d)(2)(i) (1961). Cf., *The First Nat'l Corp. of Portland v. Commissioner*, 147 F.2d 462 (9th Cir. 1945); *Inland Prods. Co. v. Blair*, 31 F.2d 867 (4th Cir. 1929).

18. See text at note 10.

19. 274 U.S. 398 (1927). See also *Wyman v. United States*, 166 F. Supp. 766 (Ct. Cl. 1958); *Jacob F. Brown*, 18 B.T.A. 859 (1930), *aff'd*, 54 F.2d 563 (1st Cir. 1931), *cert. denied*, 286 U.S. 556 (1932).

\$70,000, with the Mixed Claims Commission. The taxpayer claimed for income tax purposes that it had sustained a deductible loss at the time of the seizure in 1918. The Commissioner argued that the loss was not evidenced by a closed and completed transaction in that year.

The United States Supreme Court noted that the taxpayer did not have a right to demand the release of the subsidiary, nor compensation for its seizure during the pendency of the war. The prospect of any recovery was made to depend upon the "hazards of war."

The Supreme Court held that the taxpayer had sustained a tax deductible loss in 1918 and said:<sup>20</sup>

The quoted regulations, consistently with the statute, contemplate that a loss may become complete enough for deduction without the taxpayer's establishing that there is no possibility of an eventual recoupment. It would require a high degree of optimism to discern in the seizure of enemy property by the German government in 1918 more than a remote hope of ultimate salvage from the wreck of the war. The Taxing Act does not require the taxpayer to be an incorrigible optimist.

The principles of *White Dental* have been followed in confiscation cases arising out of the German<sup>21</sup> seizures during World War II and the Hungarian,<sup>22</sup> Polish,<sup>23</sup> Czechoslovakian<sup>24</sup> and East German<sup>25</sup> communistic expropriation programs following World War II. Such cases developed the rule of tax law that even though technically title is retained, the loss will be recognized if the foreign government takes complete control over and possession of the property. These cases have also extended the principles of *White Dental* to recognize as deductible losses the seizure of foreign property under a law which expressly provides for compensation in the future, if the actions of the foreign government evidence an attitude to ignore the compensation features of the law.<sup>26</sup> In such cases, the taxpayer is not required to be an "incorrigible optimist."<sup>27</sup>

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20. *United States v. White Dental Mfg. Co.*, 274 U.S. 398, 402 (1927).

21. *Rozenfeld v. Commissioners*, 181 F.2d 388 (2d Cir. 1950); *Wyman v. United States*, 166 F. Supp. 766 (Ct. Cl. 1958); *Mayer v. United States*, 111 F. Supp. 251 (Ct. Cl. 1953); *Ernest Adler*, 8 T.C. 726 (1947); *Eugene Houdry*, 7 T.C. 666 (1946).

22. *Peter S. Elek*, 30 T.C. 731 (1958); *Dezso Goldner*, 27 T.C. 455 (1956); *Andrew Solt*, 19 T.C. 183 (1952); *Tibor Daniel*, 29 P-H Tax Ct. Mem. 1684 (1960); and *Madeleine Feiks*, 27 P-H Tax Ct. Mem. 547 (1958).

23. *Stanislaw Mikolajcyk*, 24 P-H Tax Ct. Mem. 529 (1955).

24. *Wenimann v. United States*, 278 F.2d 474 (2d Cir. 1960); *Erwin de Reitzes-Marienwest*, 21 T.C. 846 (1954).

25. *Wladimir Von Dattan*, 22 T.C. 850 (1954).

26. Although the decree provides that the nationalization 'shall be effected against compensation,' the petitioner has received no compensation or offer of compensation. . . . The attitude of the present Hungarian Government toward its own nationals offers little reason to hope that compensation will be forthcoming to it.

*Peter S. Elek*, 30 T.C. 731 (1958).

27. *United States v. White Dental Mfg. Co.*, 274 U.S. 398, 402 (1927).

### B. *Response of Internal Revenue Service*

Under the principles of the preceding cases, the Cuban seizures should have been treated as deductible losses under Section 165(a) since the Cuban Government refused to provide an effective compensation program. Finally, in November of 1962, the Internal Revenue Service broke its long period of silence on the Cuban loss situation. The Service issued Revenue Ruling 62-197, which held that the acts of the Cuban Government in arbitrarily taking property in Cuba without any realistic effort to provide for prompt and adequate compensation amounted to confiscation of the properties involved, and give rise to deductible losses under Section 165(a).<sup>28</sup> The Ruling stated that:<sup>29</sup>

Acts of confiscation, whether by way of seizure, intervention in, expropriation, or similar taking of property, by the Cuban Government constitute identifiable events which, in the light of all of the circumstances, have resulted in closed and completed transactions notwithstanding promise of indemnification.<sup>30</sup>

Revenue Ruling 62-197 did not set forth any new principles of law for the tax treatment of foreign confiscation losses, but rather the Ruling was in most part declaratory of existing rules of law. The significance of the Ruling was that the Internal Revenue Service officially acknowledged that the Cuban seizures had given rise to tax deductible losses under Section 165(a) and that this issue would not be raised by the Internal Revenue Service in Cuban loss audits.

### C. *Deductible Losses*

Section 165(c) limits the deduction of losses under Section 165(a) to the following categories:<sup>31</sup>

1. losses incurred in a trade or business;
2. losses incurred in any transaction entered into for profit, though not connected with a trade or business; and
3. losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty or from theft.

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28. Rev. Rel. 197, 1962-2 CUM. BULL. 66.

29. *Id.* at 69.

30. "Nationalization" ordinarily refers to taking an entire industry. "Expropriation" customarily means the taking of specific property in return for compensation. "Confiscation" generally means the taking of specific property without compensation. "Intervention" usually means a temporary occupation during which period profits or rentals will continue to accrue to the owner. See, e.g., *Commissioner v. Gillette Motor Transp., Inc.*, 364 U.S. 130 (1960).

31. INT. REV. CODE OF 1954, § 165(c). Business and nonbusiness bad debts are deductible under INT. REV. CODE OF 1954, § 166(a). The war loss provisions of § 127(a) of the INTERNAL REVENUE CODE OF 1939 are not applicable to the Cuban expropriations. Section 127(a) dealt only with property lost during World War II as a result of enemy action or occupation. *Wladimir Von Dattan*, 22 T.C. 850 (1954).

A confiscation loss of a business nature will qualify under Section 165(c)(1) or (2). It has been argued that a confiscation loss of non-business property (such as a home, jewelry, clothing, etc.) should be treated as a "theft" or "casualty" loss and deductible under Section 165(c)(3).<sup>32</sup> However, the Internal Revenue Service has taken the position that, in the absence of special legislation, the loss of non-business property does not constitute a deductible casualty loss under Section 165(c)(3).<sup>33</sup> This position of the Internal Revenue Service was sustained by the Tax Court in *William J. Powers*, wherein the Court said:<sup>34</sup>

It seems clear that the confiscation of petitioner's automobile by officials in East Germany acting under color of legal authority, arbitrary and despotic as it may have been, could not have been a theft for tax deduction purposes.

... The deduction was not permissible either as a theft or as a casualty.

The Internal Revenue Service in Revenue Ruling 62-197 limited the deduction of Cuban confiscation losses to: (1) losses incurred in a trade or business; and (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business. The Service reaffirmed its position that confiscation losses are not casualty or theft losses within the meaning of Section 165(c)(3) of the Code.<sup>35</sup> Consequently, non-business losses were not deductible.

#### D. Characterization of Loss

Confiscation losses allowable under Section 165(c) must be characterized as either capital or ordinary loss deductions. A capital loss will be limited to offsetting any capital gains, plus \$1,000 of ordinary income in the case of an individual taxpayer but only to capital gains in the case of a corporate taxpayer. An ordinary loss will be deductible in full against ordinary income as well as any capital gains.<sup>36</sup>

Revenue Ruling 62-197 provides that Section 1231 of the Internal Revenue Code of 1954 is applicable in characterizing the Cuban seizures as either capital or ordinary loss deductions. Section 1231 requires the aggregating of: (a) all recognized gains and losses on sales or exchanges of property used in a trade or business;<sup>37</sup> (b) recognized gains and

32. *Weinmann v. United States*, 278 F.2d 474 (2d Cir. 1960); *William J. Powers*, 36 T.C. 1191 (1961).

33. I.T. 4086, 1952-1 CUM. BULL. 29.

34. *William J. Powers*, 36 T.C. 1191, 1192, 1193 (1961).

35. Rev. Rul. 197, 1962-2 CUM. BULL. 66, 68: "Losses sustained through confiscation or seizure of property under the authority of laws of a foreign country are not casualty or theft losses within the meaning of Section 165(c)(3) of the Code." See I.T. 4086, C.B. 1952-1, 29, and *William J. Powers v. Commissioner* 36 T.C. 1191 (1961).

36. INT. REV. CODE OF 1954, §§ 1211, 1212.

37. The term "property used in the trade or business" is defined in general by the code as property used in the trade or business, of a character which is subject to the allowance



losses from involuntary conversions of property used in a trade or business; and (c) recognized gains and losses from involuntary conversions of capital assets held for more than six months.<sup>38</sup> Section 1231(a) defines the term "involuntary conversion" to include "seizure, or an exercise of the power of requisition or condemnation." If the aggregate gains exceed the aggregate losses, they are considered gains and losses from sales or exchanges of capital assets held for more than six months. If such gains do not exceed such losses, they are considered ordinary gains and losses.

In the case of a taxpayer who has no Section 1231 gains during the year of loss, the Cuban seizure of assets used in the taxpayer's trade or business and capital assets held for more than six months will give rise to ordinary losses.<sup>39</sup>

Section 1231 does not apply to assets held for a period of less than six months. However, the confiscation of such assets will give rise to an ordinary loss deduction since the loss does not meet the definition of "capital loss" as defined in Section 1222.<sup>40</sup>

Generally, a taxpayer's investment in the stock of a corporation will be regarded as a capital asset. The question may arise whether the seizure of the taxpayer's stock or, as was generally the case, the seizure of the corporation's Cuban assets, will give rise to a loss within the purview of Section 1231 and thus qualify for potential ordinary loss deduction consequences. The Internal Revenue Service took the position in Revenue Ruling 62-197 that United States taxpayers who owned securities in corporations whose assets were confiscated were entitled to claim relief under Section 165(g) on the ground that such securities had become worthless, thereby producing a capital loss on the last day of the taxable year in which the seizure occurred.<sup>41</sup> However, if the tax-

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for depreciation, held for more than six months, and real property used in the trade or business, held for more than six months—which is not inventory, copyrights, etc. Section 1231(b)(1). The term also includes unharvested crops and livestock (as defined in the statute) which is particularly important since Cuba was predominantly an agricultural country. See INT'L COMMISSION OF JURISTS, CUBA AND THE RULE OF LAW 11 (1962).

38. INT. REV. CODE OF 1954, § 1231(a).

39. Rev. Rul. 197, 1962-2 CUM. BULL. 66, 70; Rev. Rul. 149, 1964-1 CUM. BULL. 233.

40. A "capital loss" is defined as "loss from the sale or exchange of a capital asset." INT. REV. CODE OF 1954, § 1222(2). A seizure does not constitute a "sale or exchange." Therefore, the limitation provisions of § 1211 are not applicable and the loss is deductible in full.

41. INT. REV. CODE OF 1954, § 165(g). In general the statute defines "security" as stock in a corporation; stock rights; and bonds, debentures, notes or certificates issued by a corporation or by a government with interest coupons in registered form. INT. REV. CODE OF 1954, § 165(g)(2). Credit obligations which do not meet the definition of § 165(g)(2) may be deductible as a bad debt under § 166(a) of the INTERNAL REVENUE CODE OF 1954. Shrinkage in the value of stock, even though extensive, does not give rise to a deduction if the stock has any recognizable value on the date claimed as the date of loss. Treas. Reg. § 1.165-4(a) (1960). The Commissioner stated in Revenue Ruling 62-197, at page 70:

It is to be noted that if, for example, a domestic corporation had assets outside Cuba (including potential United States tax refund claims resulting from the

payer's corporate stock was confiscated, it would appear that the loss is subject to Section 1231 instead of Section 165(g), thereby producing an ordinary loss deduction.<sup>42</sup>

If a United States parent corporation had a domestic subsidiary operating in Cuba whose assets were nationalized, then the parent corporation may claim an ordinary loss under Section 165(g)(3) if the parent corporation owns 95 per cent or more of the stock and 90 per cent or more of its gross receipts are derived from other than passive investment income.<sup>43</sup> In the case of a Cuban subsidiary corporation, the seizure would constitute a capital loss rather than an ordinary loss under Section 165(g).<sup>44</sup>

Although it seems the language in Section 1231(a)(2) conflicts with the language in Section 165(g), it is believed that the Commissioner's view would prevail and the loss or worthlessness of capital stock resulting from the seizure of underlying assets will be treated as a "capital loss" by reason of the express provisions of Section 165(g).

Prior to 1964, corporate and individual taxpayers were permitted to carryover a net capital loss for a period up to five years as a short-term capital loss.<sup>45</sup> Under the Revenue Act of 1964, individual taxpayers are permitted to carryover a net capital loss for an unlimited period of time.<sup>46</sup> In September, 1964, by special act, Congress amended the Code to permit a corporate taxpayer to carryover to the ten succeeding taxable years net capital losses sustained from the expropriation of its property directly, or

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operation of section 172 or other sections of the Code) which exceeded its liabilities (other than liabilities from which the corporation has been relieved as a result of actions of the Cuban Government), the securities would not be considered worthless for the purposes of Section 165(g).

42. Erwin de Reitzes—Marienwert, 21 T.C. 846 (1954). Law 890 of October 13, 1960, Official Gazette (special ed. Oct. 13, 1960) was enacted to expropriate Cuban controlled enterprises and resources in a similar fashion as the Cuban Government had expropriated American owned properties under prior decrees. Law 890 purported to adjudicate in favor of the Cuban Government the capital stocks of the companies listed. Cuban nationals claiming Cuban corporate stock losses resulting from Law 890, should characterize such losses as ordinary under § 1231 rather than a capital loss under § 165(g). However, such a loss would only be deductible in the year of the expropriation and would not be subject to the net operating loss carryover benefits of § 172 or the capital loss carryover benefits of § 1212.

43. Section 165(g) provides that any security in an affiliated corporation (as defined in such subsection) with a domestic corporation is not treated as a capital asset if the 95% of stock ownership and 90% of gross receipts tests stated therein are met. Section 1244 provides that a loss arising from the worthlessness of small business stock may be treated as an ordinary loss. However § 1244 is limited to individual taxpayers and to domestic corporations, and will be of limited use in the Cuban loss cases.

44. Section 165(g) is limited to domestic corporations.

45. INT. REV. CODE OF 1954, § 1212.

46. INT. REV. CODE OF 1954, § 1212(b) as amended, Revenue Act of 1964, § 230(a). The amendment applies to taxable years beginning after December 31, 1963. Capital loss carryovers to any taxable year beginning after December 31, 1963 will be treated as short-term capital losses for purposes of § 230. A capital loss realized in a taxable year beginning after December 31, 1963 which is carried forward to future years will retain its characterization as either short-term or long-term. INT. REV. CODE OF 1954, § 1212(b)(1)(A) and (B).

from securities in other corporations which become worthless by seizure of underlying assets.<sup>47</sup> This provision applies to losses sustained in taxable years ending after December 31, 1958. It is not necessary for the corporation to make a special election for the ten year carryover feature. These amendments will enable individual and corporate taxpayers who sustained heavy Cuban capital losses to realize greater tax benefits in the absence of offsetting capital gains in future years.

### *E. Net Operating Losses*

In many cases, a taxpayer's Cuban losses will exceed his income for the year of the losses. In such a situation, the taxpayer may rely upon the net operating loss carryback and carryover provision of Section 172<sup>48</sup> to obtain maximum benefit from confiscation losses sustained in Cuba.

In general, Section 172 provides that if losses and expenses exceed income for a particular year the excess or net loss, as adjusted,<sup>49</sup> may be carried back three taxable years and forward five taxable years, in succession until exhausted, as a deduction against the taxable income of the years noted. The net operating loss deduction, as a result of the adjustments in the Code, will consist of trade or business and casualty losses.

Losses incurred in a transaction entered into for profit, generally referred to as non-business losses, will be excluded in computing the net operating loss deduction except to the extent of non-business income in the year of loss.<sup>50</sup> The Treasury Regulations define non-business income and deductions as those "not attributable to, or derived from, a taxpayer's trade or business."<sup>51</sup> Non-business income is generally regarded as income from passive investments such as interest, dividends, annuities, etc., even though such income constitutes the taxpayer's sole source of income.<sup>52</sup>

The taxpayer will generally seek to qualify his Cuban losses as trade or business losses for purposes of Section 172 and failing this objective, will seek to qualify the losses as capital loss carryovers for maximum tax benefit.<sup>53</sup>

### *F. Cuban Loss Legislation*

The catastrophic expropriation losses suffered by a number of corporate and individual taxpayers gave rise to two major changes in the Revenue Act of 1964.

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47. INT. REV. CODE OF 1954, § 1212(b), as amended, Pub. L. 88-571, § 7(a).

48. INT. REV. CODE OF 1954, § 172.

49. The adjustments required are set out in INT. REV. CODE OF 1954, § 172(d).

50. INT. REV. CODE OF 1954, § 172(d)(4).

51. Treas. Reg. § 1.172-3(a)(3)(i) (1961).

52. It is interesting to note that rent even from a single rental property, generally has been held by the courts to be business income. See, e.g., *Reiner v. United States*, 222 F.2d 770 (7th Cir. 1955); *Leland Hazard*, 7 T.C. 372 (1946).

53. Losses arising from property held for the production of income will not qualify for the carryback and carryover benefits of § 172. See, INT. REV. CODE OF 1954, § 172(d)(4).

## 1. TEN YEAR CARRYOVER

The three year carryback provisions of Section 172 failed to provide sufficient tax relief to taxpayers who had little or no income for the three year period prior to the year of loss. To remedy this situation, Congress amended Section 172 to grant a taxpayer the option of electing to carryover that portion of a net operating loss arising from foreign expropriations for ten successive years rather than a three year carryback and a five year carryover.<sup>54</sup>

The new carryover provisions are limited to losses attributable to a trade or business,<sup>55</sup> and the election is applicable only if the foreign expropriation losses (as defined in the new Subsection) exceed fifty per cent of the total net operating loss for the same taxable year.<sup>56</sup> The proposed Treasury Regulations provide that the taxpayer must file the election on or before December 31, 1965, with the Internal Revenue district in which the taxpayer filed his tax return for the year of the expropriation losses.<sup>57</sup> This amendment is not limited to Cuban losses but is applicable to expropriations by other foreign countries.

The amendment to Section 172 defines "foreign expropriation loss" as:<sup>58</sup>

the sum of the losses sustained by reason of the expropriation, intervention, seizure or similar taking of property by the government of any foreign country, any political subdivision thereof, or any agency or instrumentality of the foregoing.

## 2. CASUALTY LOSSES

In the Revenue Act of 1964, Congress also attempted to aid the taxpayer who had purely personal losses. Congress added a new subsection (i) under Section 165 of the 1954 Code which provides that any loss of tangible property incurred by reason of expropriation by the Cuban Government, or its agencies, is to be treated as a casualty loss under Section

54. INT. REV. CODE OF 1954, § 172(b) and (k) as amended, Revenue Act of 1964, § 210.

55. As previously noted, confiscation losses do not qualify as "casualty" losses under §§ 165(c)(3) and 172(d)(4)(D). William J. Powers, 36 T.C. 1191 (1961); I.T. 4086, 1952-1 CUM. BULL. 29. Cuban losses qualifying under § 165(i) will be subject to the three year carryback and five year carryback provisions of § 172(b)(1)(A) and (B) but are not subject to the ten year carryover provisions of § 172(b)(1)(D). INT. REV. CODE OF 1954, § 165(i)(2)(C), as amended, Pub. L. 88-348, § 3(a) (1964).

56. Carrybacks and carryovers of net operating losses for the other taxable years are excluded in determining if the expropriation loss exceeds 50% of the total net operating loss for the year in issue. INT. REV. CODE OF 1954, § 172(k)(2). The expropriation loss is treated separately from operating losses with the operating losses being offset first. However, the expropriation loss is offset before operating losses sustained in years after the expropriation. INT. REV. CODE OF 1954, § 172(b)(2); Proposed Treas. Reg. § 1.172-11(e) (1964), 29 Fed. Reg. 203 (1964).

57. Proposed Treas. Reg. § 1.172-11(c)(3) (1964), 29 Fed. Reg. 203 (1964) sets forth the information to be supplied by the taxpayer in making the election to carry forward the expropriation loss for 10 years.

58. INT. REV. CODE OF 1954, § 172(k)(1), as amended, Revenue Act of 1964, § 210(a)(5).

165(c)(3).<sup>59</sup> The amendment proposed to treat both business and purely personal expropriations of tangible property as casualty losses. Section 165(i) applies only to Cuban expropriation losses as opposed to Section 172(k) which encompasses all foreign expropriation losses.

Subsection (i) was added to Section 165 as an amendment from the floor of the Senate, and amended by the House-Senate Conference Committee.<sup>60</sup> Apparently, as a result of legislative oversight, the proposed amendment failed to contain an effective date and consequently was only prospective in application from February 26, 1965, the effective date of the Revenue Act of 1964.<sup>61</sup> Unfortunately, by December, 1961, the Cuban Government either by decree or force had expropriated all property in Cuba owned by United States citizens and Cuban nationals who had left Cuba.<sup>62</sup>

The failure to make the amendment retroactive was first discovered in joint committee, but at this phase of the legislative procedure it was too late to amend. The joint committee recommended that Congress consider future legislation to make this provision effective for taxable years ending after December 31, 1958, and that the scope of this provision be reexamined in detail.<sup>63</sup>

This recommendation was subsequently acted upon by Congress in the form of a rider attached to the excise tax rate extension bill which completely rewrote Section 165(i).<sup>64</sup> The rewritten version was made retroactive in application by permitting refund claims thereunder to be filed by January 1, 1965, for expropriation losses prior to January 1, 1964, but the scope of the original version was limited.

The subsection was limited to losses sustained by taxpayers who were either citizens or resident aliens of the United States on December 31, 1958.<sup>65</sup> It is apparent that Congress did not intend to extend the benefits of the new subsection to the many Cuban nationals who entered the United States after Castro came to power on January 1, 1959.<sup>66</sup>

The new subsection (i) does not apply to expropriation losses of property used in a trade or business or for income-producing purposes.

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59. INT. REV. CODE OF 1954, § 165(i), as amended, Revenue Act of 1964, § 238.

60. 110 CONG. REC. No. 23, p. 3 (Feb. 7, 1964).

61. 110 CONG. REC. 3401 (Feb. 25, 1964).

62. The bulk of American-owned property was confiscated under the Agrarian Reform Law of May 17, 1959, Official Gazette (special ed. June 3, 1959) and Law 851 of July 6, 1960, Official Gazette (July 7, 1960). The Cuban nationals who fled to this country lost their properties principally under Law 890 of October 13, 1960, Official Gazette (special ed. Oct. 13, 1960), Urban Reform Law of October 14, 1960, Official Gazette (special ed. Oct. 14, 1960) and Law 951 of December 5, 1961, Official Gazette (Dec. 6, 1961).

63. 110 CONG. REC. 3401 (Feb. 25, 1964).

64. Pub. L. 88-348, § 3(b), amending INT. REV. CODE OF 1954, § 165(i).

65. INT. REV. CODE OF 1954, § 165(i)(1), as amended, Revenue Act of 1964, § 238.

66. See note 6, *supra*.

Such losses are to be governed by Section 165(c)(1) and (2).<sup>67</sup> The effect is to limit deductions under Section 165(1), as amended, to losses of purely non-business property. However, the subsection was broadened to recognize intangible as well as tangible losses, but as regards tangible property, it must have been held by the taxpayer and located in Cuba on December 31, 1958. It is not clear why Congress allowed intangible but not tangible property acquired after December 31, 1958, to qualify under Section 165(i), as amended.<sup>68</sup>

Subsection (i), as amended, also provides that any loss thereunder will be presumed to have occurred on October 14, 1960.<sup>69</sup> The taxpayer has the burden of proving that the loss was sustained on some other date. It is not clear why Congress selected this particular date, especially when the vast bulk of American-owned properties in Cuba was confiscated prior to this date by other decrees.<sup>70</sup> The Cuban Government did issue the Urban Reform Law on October 14, 1960,<sup>71</sup> which "intervened" all rental real estate in Cuba and transferred ownership to the tenants then occupying those properties, but the Urban Reform Law did not apply to any other kind of property.

The majority of the Cuban nationals who fled to the United States probably lost their property or compensation rights for previously taken property under Law 989, dated December 5, 1961.<sup>72</sup> This law provided that all Cuban nationals who did not return to Cuba within thirty days would lose their properties. This latter decree did not contain a provision for compensation and in substance extinguished any right the taxpayer may have had to compensation for seizures under any of the prior expropriation laws.<sup>73</sup>

Congress greatly aided the taxpayer by providing a presumptive date of loss since it is frequently quite difficult to prove the actual date of a confiscation loss. The Cuban Government rarely gave a receipt for

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67. INT. REV. CODE of 1954, § 165(i)(1)(B), as amended, Revenue Act of 1964, § 238.

68. Rev. Rul. 87, 1965 INT. REV. BULL. No. 14, at 6, states that in the case of intangible property acquired by an individual after December 31, 1958, the fair market value of such property immediately before the loss shall be used for purposes of § 165(i). The Ruling also sets forth acceptable procedures for determining bank deposit losses.

69. INT. REV. CODE of 1954, § 165(i)(2)(A), as amended, Revenue Act of 1964, § 238.

70. See note 57, *supra*.

71. Official Gazette, Oct. 14, 1960. The former owners were to receive indemnification in relation to the rent that the tenants had previously paid. The law also transferred mortgages to the state, describing such as immoral and exploitive.

72. Official Gazette (Dec. 6, 1961).

73. Law 989 was cited by the Commissioner in Rev. Rul. 149, 1962-2 CUM. BULL. 66. However in determining the date of loss for the property in issue, the Commissioner relied upon the effective date of the Urban Reform Law, October 15, 1960 rather than the date the Cuban taxpayer's right to compensation was extinguished by Law 989 of December 5, 1961. See note 66, *supra*.

property seized, and property was frequently taken without a published notice.<sup>74</sup>

The entire casualty loss qualifies for the net operating loss deduction under Section 172. However, Congress limited the practical benefit of Section 172 by providing that losses qualifying under 165(i) shall not be considered as expropriation losses under Subsection 172(k).<sup>75</sup> Hence, a taxpayer cannot elect to use the new ten-year net operating loss carryover provision of Section 172, but must use the three-year carryback and five-year carryover of Section 172.<sup>76</sup> The only other losses qualifying under Section 172 are seizures of assets attributable to a "trade or business." The remaining category under Section 165(c), "losses incurred in any transaction entered into for profit," are not included in the carryback and carryforward provisions of Section 172. This produces the odd result of allowing the loss of vacant land used in a trade or business or acquired for a future personal residence to be treated as a net operating loss under Section 172, but denying the benefits of Section 172 to the loss of vacant land acquired in an isolated transaction for resale at a profit.<sup>77</sup>

The amended subsection requires that the fair market value of the property be determined as of December 31, 1958, for purposes of computing the casualty loss.<sup>78</sup> Congress apparently believed that property in Cuba had substantially declined in value by October 14, 1960, the presumptive date of loss, and that true value could not properly be measured as of this date.

The benefits of Section 165(i) have been seriously restricted by the requirement that refund claims under this subsection must have been filed by January 1, 1965, for all years in issue.<sup>79</sup> Inasmuch as the rewritten provision became effective as of June 30, 1964, it is reasonable to assume many taxpayers who could have benefited thereunder did not receive notice of the new Section until after January 1, 1965, when they made their

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74. INT'L COMMISSION OF JURISTS, *CUBA AND THE RULE OF LAW* 241-45 (1962). A Cuban businessman testifying regarding the confiscation of his properties at page 245:

Q. Did they [Cuban police] give you any document certifying which properties and belongings they had taken?

A. No, they asked me to give them the deeds of my properties, but I played for time and gave them nothing. I still have the deeds as well as my bonds and shares in all the firms in which I had an interest.

Q. Did the Government compensate you for your property by giving you any form of bonds or securities?

A. No, absolutely nothing.

75. INT. REV. CODE OF 1954, § 165(i)(2)(C), as amended, Revenue Act of 1964, § 238.

76. INT. REV. CODE OF 1954, § 172(b)(1)(A) and (B), as amended, Revenue Act of 1964, § 210(a)(1)-(4), (b).

77. INT. REV. CODE OF 1954, § 172(d)(4).

78. The Tax Court has held that cost is relevant to the determination of fair market value under § 165(i). Philip W. Conrad, P-H 1965 Tax Ct. Mem. ¶ 65, 149.

79. INT. REV. CODE OF 1954, § 165(i)(3), as amended, Revenue Act of 1964, § 238. This subsection also provides that interest will not be allowed for any such refund for any period prior to February 26, 1964.

annual visit to their "tax man." Congress should have extended the deadline for filing refund claims at least until April 15, 1965.<sup>80</sup>

### III. RESIDENT ALIEN CUBAN LOSSES

#### A. *Administrative Oversight*

The Internal Revenue Service, as previously discussed, was relatively slow in issuing guidelines for the tax treatment to be accorded the Cuban expropriations.<sup>81</sup> The long awaited pronouncement by the Service, Revenue Ruling 62-197, expressly stated that the Cuban expropriations were deductible losses for United States citizens and corporations.<sup>82</sup> Further, the Ruling expressly stated that *nonresident* aliens were not entitled to deduct Cuban losses.<sup>83</sup> However, the Ruling failed to mention the income tax consequences for Cuban expropriation losses suffered by *resident* aliens and thus it was subject to the interpretation that the Internal Revenue Service would disallow Cuban expropriation losses claimed by resident aliens.

On the other hand, a persuasive argument could be presented from the Treasury Regulations and prior case decisions that resident aliens as well as United States citizens were entitled to deduct Cuban expropriation losses. To say the least, the Service's failure to refer to the resident alien was confusing. This potential conflict in the interpretation of the intent of Ruling 62-197 as to resident aliens necessitates an analysis of the tax status of resident aliens, particularly those who chose to flee the communist tyranny of Cuba and settle in the United States.

#### B. *Taxation of the Resident Alien*

The regulations interpreting the Internal Revenue Code recognize three classes of individual taxpayers: citizens, resident aliens, and nonresident aliens.<sup>84</sup> In general, the tax liability of a United States citizen and a *resident alien* are to be computed in the same manner under the income and deduction provisions of the Internal Revenue Code. Treasury Regulation Section 1.871-1 provides:

For purposes of the income tax, alien individuals are divided into two classes, namely, resident aliens and nonresident aliens.

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80. Casualty losses under § 165(i) will be subject to the \$100.00 deductible provision of § 165(c), as amended, Revenue Act of 1964, § 208(a).

81. See discussion in text at footnote 28.

82. Rev. Rul. 197, 1962-2 CUM. BULL. 66.

83. Rev. Rul. 197, 1962-2 CUM. BULL. 66, 69.

84. Treas. Reg. § 1.1-1(b) (1956), provides, in part:

In general, all citizens of the United States, wherever resident, and all resident alien individuals are liable to the income taxes imposed by the Internal Revenue Code of 1954 whether the income is received from sources within or without the United States.

The Internal Revenue Service divides the tax year into periods of nonresidency and residency for the new resident alien. I.T. 3926, 1948-2 CUM. BULL. 48.



Resident aliens are, in general, taxable the same as citizens of the United States; that is, a resident alien is taxable on income derived from all sources, including sources without the United States. Nonresident aliens are taxable only on income from sources within the United States.

The case law has adopted the Regulation's interpretation of taxing resident aliens in the same manner as United States citizens. In *David Schnur*, involving a loss deduction by a resident alien, the Tax Court stated:<sup>85</sup>

Supplement H of the code, sections 211 *et seq.*, treats nonresident aliens as a separate class of taxpayers, thereby indicating the fact that under the code citizens and resident alien taxpayers are to be treated the same for income tax purposes.

Since the Regulations and case law hold that a resident alien and a United States citizen are to be taxed in the same manner, it logically follows that a resident alien is entitled to each exemption and deduction to which a United States citizen may be entitled, unless the Code expressly provides otherwise. Since Sections 165 and 166 contain no such limitation, it may be concluded that a resident alien is entitled to deduct his losses under Sections 165 and 166 to the same extent a United States citizen may rely upon those loss deduction provisions.

The benefits of Sections 165, 166 and 172 are not limited to losses of property located within the United States. United States citizens and *resident aliens* are entitled to deduct losses of property located within foreign countries.<sup>86</sup> The Code speaks in terms of the "taxpayer" and not in terms of the situs of the property.

This tax principle was applied by the Tax Court in *Stanislaw Mikolajczyk*.<sup>87</sup> The facts of this case in chronological order were as follows:

1. October, 1947, the taxpayer fled to Poland to save his life. Until this date the taxpayer had been a Polish citizen and resident.
2. November 15, 1947, the taxpayer was declared guilty of treason by the Polish Communist Government.
3. November 22, 1947, the taxpayer was stripped of his Polish citizenship.

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85. 10 T.C. 208, 214 (1948). The Tax Court further stated: "The code imposes a tax upon the net income of 'every individual'; it makes no distinction between a citizen and a resident alien." *Ibid.* In an earlier decision, the Tax Court had said: "There is no suggestion that petitioner's status as a resident alien grants or subjects him to different treatment from that of a citizen." Eugene Houdry, 7 T.C. 666, 669 (1946).

86. *Cf.*, Treas. Reg. § 1.1-1(b) (1960). See *United States v. White Dental Mfg. Co.*, 274 U.S. 398 (1927); *David Schnur*, 10 T.C. 208 (1948); Eugene Houdry, 7 T.C. 666 (1946).

87. 24 P-H Tax Ct. Mem. 529 (1955).

4. November 26, 1947, the taxpayer arrived in the United States, and has remained in this country since that time.
5. December, 1947, the Polish Government officially confiscated the taxpayer's farm and home located in Poland.

The taxpayer argued that since he had become a resident alien of the United States on November 27, 1947, and his property had been confiscated in December, 1947, he was entitled to deduct the losses on his 1947 income tax return.

The Commissioner argued that based on the entire record the taxpayer's property had been irretrievably lost or had become worthless prior to November 26, 1947, due to the circumstances under which he fled from Poland.

The Tax Court held for the resident alien taxpayer and allowed the deduction for the adjusted basis of the farm and 75 per cent of the adjusted basis of the house which had been used for business purposes. The Court reasoned that adjudging one guilty of a crime and depriving him of his citizenship does not automatically deprive him of his property. The Court ruled that under Polish law, the property was legally expropriated in December, 1947, which was after the taxpayer became a resident alien of the United States.

The question of a resident alien deducting Cuban losses was even more confusing by reason of Revenue Ruling 61-118<sup>88</sup> which stated that Cuban refugees who enter the United States under a temporary visitor's visa, within a few months request political asylum, and are granted indefinite departure status with the right to work in the United States, or are admitted as parolees under Section 212(d)(5) of the Immigration and Nationality Act, will be classified as alien residents of the United States for income tax purposes. This 1961 Ruling appeared to approve taxing the many new Cuban residents in the same manner as United States citizens but the 1962 Ruling appeared to prohibit the Cuban resident from claiming Cuban losses otherwise allowable to United States citizens.

### *C. Administrative Recognition of Alien's Losses*

In May of 1964, the Internal Revenue Service in Revenue Ruling 64-149, resolved the issue and announced that resident aliens were entitled to the tax benefits of Revenue Ruling 62-197,<sup>89</sup> and evidenced a

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88. Rev. Rul. 118, 1961-1 CUM. BULL. 5.

89. Rev. Rul. 149, 1964-1 CUM. BULL. 233. The Ruling stated at page 234:

Although that ruling (Revenue Ruling 62-197) mentioned only United States citizens and domestic corporations, the failure to discuss the deductibility of losses incurred by resident aliens occurred because none of the specific factual situations upon which the ruling was based involved losses incurred by resident aliens. In view of the foregoing, Revenue Ruling 62-197 is hereby clarified to indicate that that ruling is applicable to losses incurred by resident aliens as well as losses incurred by citizens of the United States.

sympathetic attitude to the plight of the Cuban nationals who had departed from Cuba after Castro came to power. The Ruling not only corrected any misinterpretation regarding seizure losses suffered by resident aliens, but also provided guidelines for losses sustained by Cuban nationals fleeing Cuba after 1959.

Revenue Ruling 64-149 dealt with a Cuban national who entered the United States in April, 1960 under a visitor's visa which, was the only type of visa obtainable due to the political circumstances prevailing at that time. During the same year, he left the United States on three different occasions in attempts to develop business interests in certain foreign countries.

In April, 1961, he took part in the Bay of Pigs invasion, was captured, and imprisoned in Cuba until December, 1962. He was subsequently released and he returned to the United States as a parolee under the Immigration and Nationality Act. The Ruling concluded that despite these absences he retained his status as a resident alien from April, 1960, because his departures from the United States were not coupled with an intention to abandon his United States residence. Accordingly, he was allowed to deduct his Cuban losses even though sustained only a few months after he arrived in the United States.

#### *D. Computing the Deductible Loss*

##### 1. GENERAL PRINCIPLES

Confiscation losses are computed in the same manner as other deductible losses under Section 165. The loss is measured by the adjusted basis of the property as of the date of seizure with certain limitations of fair market value in the case of losses qualifying under Section 165(i). The amount of a loss qualifying under Section 165(i) will be the lesser of the adjusted basis or the fair market value of the property at the time of expropriation.<sup>90</sup>

The adjusted basis is determined by ascertaining the original basis and making necessary adjustments for depreciation allowable even though the taxpayer was a nonresident alien during this period.<sup>91</sup> The original basis is determined as follows:

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90. Treas. Reg. § 1.165-7(b)(1) (1961). As previously discussed in the text at note 73, fair market value will be determined as of December 31, 1958 rather than the date of confiscation, except in the case of intangible property acquired after December 31, 1958, which will be valued as of the date of confiscation. Section 165(i)(2)(B); Rev. Rul. 87, 1965 INT. REV. BULL. No. 14, at 6.

91. The predecessors to § 1016(a)(3) have been so interpreted. Tibor Daniel, 29 P-H Tax Ct. Mem. 1684 (1960). For the arguments pro and con on adjustments for depreciation, see Weyher and Kelley, *The Income Taxation of Aliens—Some Riddles and Paradoxes*, 9 TAX L. REV. 371, 396 (1954).

1. If purchased, the original basis is equal to cost.<sup>92</sup>
2. If inherited, the original basis is equal to the fair market value of the property on the date of death or on the optional valuation date.<sup>93</sup>
3. If a gift, the original basis is equal to the lesser of the donor's adjusted basis or fair market value on the date of the gift.<sup>94</sup>

The original basis must be converted from foreign currency to United States dollars at the rate in effect on the applicable date.<sup>95</sup>

The Commissioner's liberal interpretation of the facts in favor of the Cuban national in Revenue Ruling 64-149 will encourage many other resident Cuban nationals to claim their Cuban losses for income tax purposes. Initially the question may arise whether the Cuban national is entitled to a tax basis for property acquired at a time when he was a nonresident alien and his income was not subject to taxation by the United States. In the case of United States citizens or corporations, assets purchased with "blocked" or unreported income will not be deductible in the event of loss.<sup>96</sup> However, the case law has made an exception to this rule in the area of taxation of the resident alien. The Internal Revenue Service acknowledges that a resident alien is entitled to a tax basis for properties in a foreign country even though these properties were acquired when the taxpayer was a nonresident alien.<sup>97</sup>

## 2. EXCHANGES

Generally, property acquired in an exchange before the Cuban national became a resident alien will be given a basis equal to its fair market value since this value represents the "price" paid for the property acquired.<sup>98</sup> However, if the property was acquired in a transfer which would have qualified as a "tax-free" exchange under the Code, then the adjusted basis of the property given should be treated as the basis of the property acquired, with adjustments for any money or other property received.<sup>99</sup>

92. INT. REV. CODE OF 1954, § 1012; *United States v. White Dental Mfg. Co.*, 274 U.S. 398 (1927); *Eugene Houdry*, 7 T.C. 666 (1946).

93. INT. REV. CODE OF 1954, § 1014; *Tibor Daniel*, 29 P-H Tax Ct. Mem. 1684 (1960); *Andrew Solt*, 19 T.C. 183 (1952).

94. INT. REV. CODE OF 1954, § 1015; *Alvary v. United States*, 302 F.2d 790 (2d Cir. 1962).

95. *Benjamin Abraham*, 9 T.C. 222, 226 (1947); *David Schnur*, 10 T.C. 208 (1948).

96. Rev. Rul. 197, 1962-2 CUM. BULL. 66. See also *Mim*, 6475, 1950-1 CUM. BULL. 50, for the tax consequences of losses in respect to blocked currency income.

97. Rev. Rul. 149, 1964-1 CUM. BULL. 233. See, *Cooney, Tax Basis of Foreign Property to a Resident Alien*, Fla. C.P.A. 14 (1963).

98. INT. REV. CODE OF 1954, § 1012.

99. INT. REV. CODE OF 1954, §§ 1031, 1032, 1033, 1034, 1035 and 1036.

## 3. CORPORATE REORGANIZATIONS

Property acquired by a Cuban national in a corporate reorganization prior to becoming a resident alien will probably be given a basis equal to its fair market value on the date of exchange, even though the transfer would have qualified under the Code as a "tax-free reorganization."<sup>100</sup> Although the Code and Regulations are silent on this point, it is reasonable to assume this result would follow by reason of Section 367 which in effect provides that the tax-free reorganization provisions are not applicable to foreign corporations unless prior to the exchange it has been established to the satisfaction of the Commissioner that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes.<sup>101</sup> The Commissioner does not have the authority to approve retroactively the exchange either for the benefit or to the detriment of the taxpayer.<sup>102</sup> In the absence of prior approval the exchange must be regarded as a taxable transaction and the property acquired must be given a basis equal to its fair market value on the date of the exchange.

## 4. CUBAN COMMUNITY PROPERTY LAWS

The laws of Cuba created a legal relationship between husband and wife known as the "conjugal partnership" which has been described as virtually and practically the same as the "community property law" existing in Texas and Washington.<sup>103</sup> The question arises whether one-half of the husband's confiscation losses must be attributed to the wife. The issue becomes pertinent in those cases where the wife entered the United States after the husband and subsequent to the confiscation of the husband's properties.

The Commissioner in an early ruling involving splitting income between a Cuban and his wife, stated that the interest of the wife in the income from the "conjugal partnership" is an interest inchoate, a mere expectancy, and accordingly such *income* should be reported in its entirety by the husband.<sup>104</sup> The reasoning of this ruling should apply to the current Cuban confiscation cases and the husband's losses should be attributable only to him.<sup>105</sup>

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100. INT. REV. CODE OF 1954, §§ 332, 333, 351, 355 and 368.

101. INT. REV. CODE OF 1954, § 367.

102. Texas-Canadian Oil Corp., Ltd., 44 B.T.A. 913 (1941).

103. I.T. 1479, 1922-2 CUM. BULL. 172.

104. *Ibid.*

105. Law No. 9 of December 20, 1950, Official Gazette (Dec. 28, 1950) seems to have been an attempt by the Cuban Legislature to abolish any of the limitations upon the wife's rights under the "conjugal partnership." However, the Internal Revenue Service has not indicated if this change in the Cuban law affected the conclusion reached in I.T. 1479, 1922-2 CUM. BULL. 172. The status of the Cuban conjugal partnership is also important in determining if the wife is entitled to claim one-half of the expropriation losses where the husband dies or divorces the wife.

### E. Resident Alien's Burden of Proof

A Cuban national claiming confiscation losses will be required to prove the date on which he became a resident alien, the date of confiscation, and the adjusted basis of the property confiscated. The loss will not be deductible unless it occurred *after* the Cuban national became a resident alien.

#### 1. PROOF OF RESIDENCY

The term resident alien is not used in the income tax law as it is used in the immigration law of the United States.<sup>106</sup>

The Treasury Regulations provide, in part, that an alien physically present in the United States without a definite intention as to his stay will be treated as an alien for income tax purposes.<sup>107</sup> Thus, a Cuban national may have become a resident alien for income tax purposes soon after his arrival in the United States although he may not become a resident alien for immigration purposes until several years later.<sup>108</sup>

The intentions of the alien as evidenced by his overt acts and statements will be instrumental in determining his status. The Service will consider such factors as length of stay,<sup>109</sup> presence of family and personal belongings,<sup>110</sup> written declarations of intention,<sup>111</sup> employment,<sup>112</sup> and type of visa or re-entry permit.<sup>113</sup> The resident alien will retain his

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106. *Mim.* 5883, 1945 *CUM. BULL.* 244, 246:

The general rule adopted by the Bureau is that the type of visa issued is only one of the elements entering into the classification of an alien as a resident or nonresident. It is believed that there are many cases now which will come under the phrase "in the absence of exceptional circumstances" because of the fact that many visitors' permits, or temporary visas, were issued to aliens who desired merely to get out of a war-torn country under any conditions and under any passport or visa so long as they reached the shores of the United States. For example, while the vast majority of such aliens originally entered the United States on temporary permits, numerous extensions of such permits have been applied for and granted and a great number of applications have been made by such aliens to enter a third country in order to qualify for reentry into the United States on immigrants' visas, thus indicating an intention to become residents of the United States even though such immigrants' visas may not have been granted. On the other hand, the possession of an immigrant's visa by an alien, upon his initial entrance into the United States, is not conclusive of his classification as a resident of this country. Those aliens, therefore, who are properly classified as residents within the meaning of the regulations referred to above and under the general rules of law relating to what constitutes residence, should in every case be required to file returns on Form 1040, accounting for income from all sources, both within and without the United States, including capital gains.

107. *Treas. Reg.* § 1.871-2(b) (1957).

108. See, note 106, *supra*.

109. *Commissioner v. Nubar*, 185 F.2d 584 (4th Cir. 1950); *Rev. Rul.* 87, 1954-1 *CUM. BULL.* 155.

110. *White v. Hofferbert*, 88 F. Supp. 457 (D. Md. 1950); *Robert W. Seeley*, 14 T.C. 175 (1950).

111. *Treas. Reg.* § 1.871-4(c) (1957). *But cf.*, *Rudolf Jellinek*, 36 T.C. 826 (1961).

112. *Stefan Kowalski*, 17 P-H Tax Ct. Mem. 784 (1948); and *John Henry Chapman*, 9 T.C. 619 (1947).

113. *I.T.* 4057, 1951-2 *CUM. BULL.* 93 as modified by *Rev. Rul.* 129, 1960-1 *CUM. BULL.* 272; and *Florica Constantinescu*, 11 T.C. 37 (1948).

status on temporary visits to foreign countries if it is his intention to return to the United States.<sup>114</sup>

The Internal Revenue Service sought to clarify the tax status of the many Cuban nationals who entered the United States as a result of the Cuban crisis in Revenue Ruling 61-118. Ruling 61-118 essentially stated that Cuban refugees who entered this country under a temporary visitor's visa and shortly thereafter requested political asylum, and were granted indefinite departure status, or who were admitted as parolees under Section 212(d)(5) of the Immigration and Nationality Act, were to be classified as resident aliens.<sup>115</sup> This Ruling, however, does not bar the Cuban national on a tourist visa from claiming resident alien status immediately after entering the United States. In Revenue Ruling 64-149 the Service recognized resident alien status in such a case, reasoning that a visitor's visa was not indicative of the Cuban national's intent since at that time he was unable to obtain any other type of visa.<sup>116</sup>

## 2. PROOF OF DATE OF LOSS

Revenue Ruling 62-197 states that the Service will recognize the loss in the year in which the acts of confiscation first occur. An officially published expropriation decree or similar document will, in the absence of evidence to the contrary, be considered as *prima facie* evidence of the confiscation as of the date of the decree. In cases where the property was seized, intervened, or taken by Cuban officials before the publication of an expropriation decree, the loss will be considered to have been sustained at the time of the physical taking. In cases where the Cuban Government did not publish an official notice before taking the property, "the date of loss may be established by whatever evidence is available, including evidence of a circumstantial nature."<sup>117</sup>

Taxpayers qualifying under Section 165(i) may rely upon the presumptive date of loss that Congress has provided, October 14, 1960. However, the taxpayer has the privilege of proving the loss occurred on some other date.<sup>118</sup>

## 3. PROOF OF OWNERSHIP AND BASIS

A taxpayer should prove the amount of his Cuban losses by submitting to the Internal Revenue Service whatever documentary proof is available, such as accounting records, deeds, stock certificates, bank rec-

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114. Josette J. F. Verrier Friedman, 37 T.C. 539 (1961); Rev. Rul. 149, 1964-1 CUM. BULL. 233.

115. Rev. Rul. 118, 1961-1 CUM. BULL. 5.

116. Rev. Rul. 149, 1964-1 CUM. BULL. 233.

117. Rev. Rul. 197, 1962-2 CUM. BULL. 66, 70.

118. See discussion in text at note 69.

ords, photographs of property, purchase invoices and other similar documents. However, American citizens and Cuban nationals who fled from Cuba to the United States after Fidel Castro came to power in January, 1958, may well encounter some difficulty in proving their Cuban losses. The Cuban Government frequently confiscated one's business records as well as one's Cuban properties. It is apparent that the Cuban Government will not cooperate by supplying such information to a United States citizen or Cuban national who has fled to this country for political reasons. Nor will the Cuban Government supply copies of land records and other publicly recorded documents which generally form the nucleus of property ownership of a civil law system.<sup>119</sup>

In the event a taxpayer is not able to produce sufficient documentary proof to satisfy the Service, he may rely upon affidavits executed by competent and responsible business and personal associates who had actual knowledge of the ownership, cost and value of the property seized.<sup>120</sup> The weight accorded to an affidavit will generally be made to depend upon laying a proper foundation as to the creditability of the affiant.

There is case authority to the effect that the taxpayer will be entitled to some deductible loss even though he is unable to prove the exact adjusted basis or fair market value of the property confiscated.<sup>121</sup>

In *Philip W. Conrad*,<sup>122</sup> the only reported Cuban expropriation case to date, the Tax Court held that the taxpayer's testimony on cost would be relevant to the determination of fair market value as of December 31, 1958, in proving a loss under Section 165(i).

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119. INT'L COMMISSION OF JURISTS, CUBA AND THE RULE OF LAW 241-45 (1962).

120. Clauss, *Foreign Expropriation Losses*, 43 TAXES 201, 210 (1965).

121. In the recent case of *Alvary v. United States*, 302 F.2d 790 (2d Cir. 1962), the taxpayer sustained certain losses when the Hungarian Communist Government confiscated his properties in Hungary. The issue was to the amount of the deductible loss as the taxpayer had acquired the property by gift. The Second Circuit rendered judgment for the taxpayer and set forth the following guidelines:

Taxpayer's expert testimony on the properties' fair market value is as precise as one can expect in light of the inherent inexactness of the concept of fair market value and the remoteness of both the location of the property and the relevant date. In response, the government, conceding that the properties have some value, challenged the accuracy of the taxpayer's estimates, but did not offer any estimates of its own. Even were the Court to accept the government's position, that the value of the properties had declined, there is no evidence in the record on which to reach a specific lesser figure. If the government fails to offer its estimate of value in a situation in which it is able to do so and no other substantial evidence on which to base a lower valuation exists, the Court may accept the taxpayer's figures.

*Id.* at 795. See also, Benjamin Abraham, 9 T.C. 222 (1947); Madeleine Feiks, 27 P-H Tax Ct. Mem. 547 (1958).

122. P-H 1965 Tax Ct. Mem. ¶ 65,149. In this decision, the Tax Court liberally interpreted the facts in favor of the taxpayer, allowing \$20,000 of a claimed \$30,000 loss under § 165(i), principally upon the basis of the taxpayer's oral testimony in court.



In *Andrew P. Solt*, where the taxpayer had great difficulty in proving the adjusted basis of certain confiscated property, the Tax Court said:<sup>123</sup>

In the circumstances, we are without any reliable guides for determining petitioner's basis. The burden was on him, and he has failed to meet it. Yet, we are satisfied on this record that he in fact did sustain a loss, and that there was in fact some adjusted basis as of June 5, 1942. In the circumstances, we cannot deny him relief altogether, cf. *Helvering v. Taylor*, 293 U.S. 507, and it is incumbent upon us to do the best we can with the materials at hand. As the Court of Appeals for the Second Circuit said in *Cohan v. Commissioner*, 39 F.2d 540, 544: . . . 'the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making.'

#### IV. CONCLUSION

The confiscatory program of the Cuban Government has made an unusual impact upon our federal income tax system, as evidenced by the three amendments to the Internal Revenue Code and the issuance of two Revenue Rulings. In addition the Cuban confiscations of over one billion dollars in American owned property is a great loss of revenue in the form of refund claims and future taxes. It may be anticipated that the loss in federal revenues will increase as a result of the liberal interpretation by the Commissioner of the resident status of Cuban nationals present in the United States. But there are sociological and fiscal problems connected with granting tax relief to individuals who have fled tyrannical governments and have become residents of the United States. In effect, the United States is subsidizing them by removing them from the tax roles to the extent of properties confiscated from them by such alien governments.

The sociological aspect of this type of subsidy as opposed to the outright grant which was given to many Cuban refugees by the federal government is not the topic of this monograph, but it is thought to be more beneficial in rehabilitation than welfare payments.

It is recommended that Congressional action is needed to clarify the Treasury Department's position as to resident aliens, so as to facilitate future claims by other aliens who might be in similar situations when they arrive in the United States.

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123. 19 T.C. 183, 188 (1952).